

STATE OF NORTH DAKOTA

COMMISSIONER OF FINANCIAL INSTITUTIONS

IN THE MATTER OF:

CybrCollect, Inc.

P.O. Box 1145

La Crosse WI 54602-1145

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**RECOMMENDED
FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER**

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On March 7, 2003, the North Dakota Department of Financial Institutions ("DFI") issued an "Order to Cease and Desist and Notice of Opportunity for Hearing" ("Order") to CybrCollect, Inc. (CybrCollect) ordering CybrCollect to "cease and desist from engaging in further acts and practices in violation of N.D.C.C. ch. 13-05." On March 21, 2003, CybrCollect served a "Request for Hearing" on DFI. On April 10, 2003, DFI submitted a "Request for Administrative Law Judge - Complaint" to the Office of Administrative Hearings ("OAH") requesting an Administrative Law Judge ("ALJ") to conduct a hearing and issue recommended findings of fact, conclusions of law, and a recommended order. The undersigned ALJ was designated on April 14, 2003. On April 17, 2003, the ALJ issued a Notice of Hearing and Specification of Issues. The notice scheduled a hearing for May 12, 2003, at the DFI offices in Bismarck. The issues specified are "[w]hether CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. ch. 13-05 such that the Commissioner may impose a cease and desist order against CybrCollect under the provisions of N.D.C.C. ch. 13-05, and whether such acts, practices or transactions require further relief beyond the imposition of a cease and desist order.

The hearing was held as scheduled. Assistant Attorney General Douglas B. Anderson represented DFI at the hearing. CybrCollect was present at the hearing through its President, Gary Doherty. CybrCollect was represented at the hearing and otherwise by Ronald H. McLean

and Jeffrey L. Skaare, Serkland Law Firm, Fargo. CybrCollect presented its case first. It called two witnesses, Mr. Doherty and Cory Back, an independent sales agent for CybrCollect. DFI called Robert Entringer, Assistant Commissioner, as its only witness. CybrCollect offered exhibits 1-9, 11-17, 19, 20, 22, 25, and 26 which were all admitted, except exhibit 26, which was made a part of the record on an offer of proof. (Exhibit 12 was offered and admitted for illustrative purposes only). DFI offered exhibits A-J. All of the DFI exhibits were admitted except exhibits B and C.

DFI filed its Post-Hearing Brief on May 23, 2003. CybrCollect filed its Post-Hearing Brief on June 9, 2003. DFI filed its Post-Hearing Reply Brief on June 16, 2003. On June 24, 2003, as the ALJ was finalizing his decision in this matter, he received a June 23, 2003, letter from CybrCollect with a copy of a transcript from a Wisconsin proceeding. The ALJ did not consider the letter or transcript in issuing this decision.

Three days before the hearing the ALJ received CybrCollect's unsolicited Pre-hearing Brief. At the hearing, DFI submitted a Motion to Strike Pre-hearing Brief and a Motion in Limine and to Limit the Scope of the Issues on Hearing.

Finally, it should be noted that on April 19 and April 22, 2003, CybrCollect and DFI, respectively, signed an "Agreement" agreeing, in part, "that CYBRCOLLECT...shall be granted a collection agency license ... and shall be permitted to perform collection activity under that license. However, CYBRCOLLECT ... may only collect collection fees electronically if it verifies that the debtor has signed a separate authorization allowing the electronic debit of the debtor's account for those fees ... The restriction of the electronic collection of fees shall remain in force permanently unless ... [DFI], the ... District Court or the ... Supreme Court issues a final determination that allows CYBRCOLLECT ... to collect those fees electronically without a separate signed authorization..."

This case involves very little, if any, factual dispute but does involve serious and complex questions of law. Based on the evidence presented at the hearing and the briefs of counsel for the parties, the administrative law judge makes the following recommended findings of fact and conclusions of law.

FINDINGS OF FACT

1. CybrCollect is a Wisconsin corporation, first licensed by the Wisconsin Department of Financial Institutions as a debt collection agency in 1999. CybrCollect's principal place of business is in LaCrosse, WI. Its sole owner is Gary Doherty, its president. CybrCollect operates in all states, with the exception of Hawaii and Rhode Island. CybrCollect was issued a collection agency license by DFI authorizing the corporation to engage in collection activity within North Dakota ("ND") under the terms of an April 2003 Agreement. CybrCollect has two sales representatives in ND who solicit ND merchants to retain the services of CybrCollect.

2. CybrCollect is in the business of contracting with merchants to electronically collect checks which have been returned for insufficient funds ("NSF checks"). As compensation for CybrCollect's services, the merchant authorizes CybrCollect to retain all or a portion of the fees (the "NSF fee") that are typically authorized by state statutes as recoverable costs of collecting NSF checks. CybrCollect receives the NSF check from the merchant's bank and makes an electronic copy. CybrCollect then uses the information from the check to electronically "re-present" the NSF check to the purchaser's bank. If the check comes back as an NSF check again, CybrCollect will attempt presentment at most one more time. Electronic re-presentment of an NSF check is not at issue in this matter.

3. What is at issue in this matter is the second part of CybrCollect's business model: the collection of the statutory NSF fee by means of an electronic debit. The North Dakota Century Code allows a merchant and its debt collector to recover a statutory fee. The statute

imposes unconditional liability on the NSF check writer for a fee up to \$25.00, and states that it is recoverable by the holder or its agent. CybrCollect's contract with the merchants requires the merchant to post a conspicuous sign explaining the collection practices and procedures, and notifying the customer that collection of the statutory fee will occur by electronic means. Exhibit 13. CybrCollect initiates an electronic debit from the consumer's account, thus recovering the statutory NSF fee.

4. CybrCollect's business, then, is the attempt to recover both the full face value of the NSF check and the statutory NSF fee, but, again, it is only the second portion of its business activity that is at issue in this matter.

5. The merchant enters into an agreement with CybrCollect, the "CybrCollect Client Agreement." Exhibit 14. The merchant also forwards to the merchant's bank a "Bank Authorization Forwarding of Return Items," in which the merchant authorizes and instructs the merchant's bank "to mail all return items after **first presentment** for payment and determination of uncollectable funds to **CybrCollect, Inc.** It is important that you forward these items after the **FIRST PRESENTATION**; please do not attempt to present each item a second time." Exhibit 15 (emphasis in original).

6. N.D.C.C. ch. 13-05 is the statute regulating collection agencies in North Dakota. N.D. Admin. Code Art. 13-04 provides DFI's rules on regulation of Consumer Finance. N.D. Admin. Code ch. 13-04-02 are the rules on Collection Agencies. N.D.C.C. Title 6 is North Dakota's statute regulating banks and banking.

7. N.D.C.C. § 13-05-02 requires collection agencies to be licensed in North Dakota. Pursuant to the April 2003 agreement CybrCollect is licensed as a collection agency in North Dakota.

8. N.D.C.C. § 6-08-16 is the statute in this state relating to issuing a check or draft without sufficient funds or credit. That statute makes it a criminal offense to write an NSF check. The statute also provides that the NSF check writer is liable for the associated fees and costs of collection. However, the statute requires neither written authorization from the consumer, nor a civil action by the payee on the check, in order to collect this fee. It imposes unconditional liability. It states, in part, as follows:

6-08-16. Issuing check or draft without sufficient funds or credit - Notice - Time limitation - Financial liability - Penalty.

2. ... The person is also liable for collection fees or costs, not in excess of twenty-five dollars, which are recoverable by the holder, or its agent or representative, of the check, draft, electronic funds transfer authorization, or order ...

9. There is nothing in N.D.C.C. ch. 13-05 that specifically forbids CybrCollect's business practices as outlined in Findings of Fact ("FOF") #s 2-5.

10. N.D. Admin. Code ch. 13-04-02 provides for the regulation of collection agencies, pursuant to N.D.C.C. ch. 13-05-06(4). N.D. Admin. Code ch. 13-04-03 is the Code of Ethical Conduct for collection agencies pursuant to N.D.C.C. § 13-05-06 (3). N.D. Admin. Code §§ 13-04-02-02, 13-04-02-04, 13-04-02-05, 13-04-02-06, 13-04-02-07, 13-04-02-08, 13-04-02-09, and 13-04-02-10 provide regulation regarding prohibited advertising and communications; prohibited practices; threats or coercion prohibited; harassment or abuse prohibited; unreasonable publication prohibited; fraudulent, deceptive, or misleading representations; unfair or unconscionable means prohibited; and postal violations prohibited, respectively. DFI generally alleges that CybrCollect's business practice is violating National Automated Clearing House Association ("NACHA") operating rules, and represents a fraudulent, deceptive, misleading, unfair and/or unconscionable means of collecting a debt in violation of N.D. Code §§ 13-04-02-08 and 13-04-02-09. However a review of those provisions, as well as the other

regulatory provisions of N.D. Admin. Code ch. 13-04-02, shows no provision that specifically forbids CybrCollect's business practices as outline in FOF #s 2-5.

11. DFI cites NACHA's Operating Rules and Operating Guidelines in support of its position that within the State of North Dakota, CybrCollect may not debit a consumer's checking account electronically, in the event of insufficient or held funds, to collect statutory service fees, without a written authorization from the consumer. NACHA Operating Rules provide:

Subsection 2.1.2 Receiver Authorization and Agreement

The authorization for RCK entries consist of a notice meeting the requirements of subsection 2.1.4 and the receipt of the item to which the ECK entry relates...

Subsection 2.1.4 Notification for Accounts Receivable Entries and Represented Check Entries

Prior to the receipt of a source document that is used as the basis for the origination of an ARC entry, the Originator must provide the Receiver with a notice that clearly and conspicuously states that the receipt of the source document will authorize an ACH debit entry to the Receiver's account in accordance with the terms of the source document.

Prior to the origination of each RCK entry, the Originator must provide the Receiver with a notice that clearly and conspicuously states the terms of the re-presented check entry policy in advance of receiving the item to which the RCK entry relates.

Exhibit D (2003 ACH Rules, OR 2)

NACHA Operating Guideline, Section IV, Chapter XI (Re-presented Check Entries) provides:

4. **COLLECTION FEES**

Re-presented check entries may be originated only for the face amount of the check. No collection fees may be added to the amount of the item when it is transmitted as an ACH entry.

An Originator desiring to use the ACH Network to collect a service fee must originate a separate PPD, TEL, or WEB debit entry to the consumer's account and must follow all rules governing the specific transaction used, including having first obtained the consumer's written authorization for such an entry in accordance with the requirements of NACHA Operating Rules.

Exhibit D (2003 ACH Rules, OG 159-OG-161).

12. CybrCollect relies on 12 C.F.R. Part 205, § 205.3(c)(1), and Supplement I to Part 205 - Official Staff Interpretations, Section 205.3(c) as the basis for its position that, within the State of North Dakota, CybrCollect may debit a consumer's checking account electronically, in the event of insufficient or held funds, to collect statutory service fees, provided it posts at each point-of-sale location notice of its Check Policy.

The Electronic Fund Transfer Act (15 U.S.C. 1693 et. seq.) enacted in 1978, provides a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems. The Act is implemented by the Federal Reserve Board's Regulation E (12 C.F.R. Part 205). The types of transfers covered by the act and the regulation include transfers restricted through an automated clearinghouse (ACH) 66 Fed. Reg. 15,187.

On March 13, 2001, the Federal Reserve Board issued revisions to Regulation E Official Staff Interpretations for the purpose of clarifying its position that a service fee related to a RCK entry collected electronically is a separate ACH transaction from the representment of the check itself and that the electronic service fee transaction falls under the jurisdiction of Regulation E. The commentary clarified that written authorization is not required under Regulation E for a one-time electronic fund transfer.

The revision to Supplement I to Part 205 - Official Staff Interpretations, Section 205.3(c), provides:

3(c) Exclusions From Coverage Paragraph 3(c)(1) - Checks

Represented checks. The electronic re-presentment of a returned check is not covered by Regulation E because the transaction originated by check. Regulation E does apply, however, to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account.

See 66 Fed. Reg. 15187, 15190 (March 16, 2001).

An excellent discussion of the two approaches, that of the NACHA and the Federal Reserve Board is found in the FDI Post-Hearing Brief, at 7-13.

13. The Uniform Commercial Code defines the rights between parties with respect to bank deposits and collections. N.D.C.C. ch. 41-04. N.D.C.C. § 41-04-03 provides for variation by agreement including the effect of Federal Reserve regulations, operating circulars, clearinghouse rules and the like. N.D.C.C. § 41-04-03(1) - (3). However, the statute does not apply to electronic fund transfers. N.D.C.C. § 41-04-02(2); 41-04-04(1)(i); 41-03-04(1) and (2); 41-03-03(1)(f) and (i). *See* excellent discussions of the provisions of the UCC in FDI Post-Hearing Brief, at 13-15, and CybrCollect's Post-Hearing Brief, at 18-20.

CONCLUSIONS OF LAW

1. CybrCollect is currently a licensed North Dakota Collection Agency operating in North Dakota pursuant to North Dakota collection agency law and has been so licensed since the signing of the April 2003 Agreement by CybrCollect and DFI.

2. By the greater weight of the evidence, the evidence does not show that CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. ch. 13-05, or rules adopted under ch. 13-05, such that the Commissioner may impose a cease and desist order

against CybrCollect under the provisions of N.D.C.C. ch. 13-05, or rules adopted under ch.13-05.

3. By the greater weight of the evidence, the evidence does not show that CybrCollect has engaged in acts, practices, or transactions that under N.D.C.C. ch. 13-05, or rules adopted under ch. 13-05, that require further relief beyond the imposition of a cease and desist order against CybrCollect.

4. The evidence shows, by the greater weight of the evidence, no specific violation of N.D.C.C. ch. 13-05 or any rule adopted under ch. 13-05. The evidence shows that CybrCollect is operating as a collection agency in North Dakota under a reasonable interpretation of the laws in regard to collection agencies in North Dakota and that, although its business activities may involve some potential risks to North Dakota consumers, none of its business activities have been specifically proscribed or prohibited by Statute or DFI rule. *See* Analysis of Law.

ANALYSIS OF LAW

First, the due process claim of CybrCollect should be addressed. Besides addressing the stated issues, CybrCollect has also contended that it was denied the right of procedural due process of law in this matter. However, the ALJ is not given authority to decide constitutional issues. *First Bank of Buffalo v. Conrad*, 350, N.W. 2d 580 (N.D. 1984); *Johnson v. Elkin*, 263 N.W. 2d 123 (N.D. 1978). Further, CybrCollect voluntarily entered into the Agreement it signed with DFI on April 19, 2003. Pursuant to that agreement, CybrCollect became licensed in North Dakota as a collection agency and specifically agreed to a restriction on its electronic collection of fees until there has been an administrative decision and/or court decision on the issues raised by the Order. It would seem that the Agreement, not the Order, governs this matter now. While

the Order could have been more specific in its allegations of violation of law, the Order is for purposes of procedure, except, perhaps, for helping to define the issues, replaced by the April 2003 Agreement. Although the ALJ cannot rule on the merits of CybrCollect's constitutional due process claim, the ALJ can and does **deny** that claim because of the Agreement. The Agreement makes the claim futile and unnecessary.

NACHA Operating Rules currently provide greater consumer protections in the matter of electronic collection of the NSF fee from the consumer's account (the portion of CybrCollect's business practices at issue in this matter), because they require written authorization by the consumer, whereas the Federal Reserve Board allows the more liberal signage posting authorization. DFI argues that the ALJ has the task of resolving the legal issue concerning the relationship between the Federal Reserve Board's and NACHA's differing authorization requirements for the electronic debiting of service fees from consumer's accounts. In particular, DFI argues, the ALJ "must decide the legal issue of whether the 'protection from civil liability' which serves as the purpose for Supplement I to Part 205 - Office Staff Interpretations, constitutes sufficient justification to permit CybrCollect, Inc., to continue violating the NACHA Operating Rules by debiting consumer's checking accounts electronically within the state of North Dakota, in the event of insufficient or held funds, to collect statutory service fees, without the required written authorization from the consumer." DFI Post-Hearing Reply Brief, at 6.

DFI misconstrues the issue and the ALJ's, and, indeed, its own role. In this matter, it is not DFI's role to resolve any legal issues that arises as a result of any conflict of interpretation of nonpublic policy and federal law between two different nonstate entities, one of which is an entity or association of participating financial institutions and the other a Federal agency or entity, the Federal Reserve Board (Federal Reserve System). DFI's role in this matter is under N.D.C.C. ch. 13-05 and N.D. Admin Code art. 13-04.

Further, there is no evidence that DFI has specifically adopted either interpretation in administrative rule. Neither interpretation is specifically covered by statute. DFI has not even issued a written policy concerning either interpretation (at least none was offered at the hearing).¹ There is simply nothing in stated North Dakota law or policy that would allow DFI to prohibit CybrCollect from interpreting the law in a reasonable fashion, as it has, based on Federal Reserve Board interpretation, to do what it currently does in its business activities. It is not against North Dakota law to do so, and DFI is, at this time, powerless to prevent it, notwithstanding any powers or duties pursuant to agreements any other entities may have in regard to the business practices of CybrCollect, and notwithstanding any risks to North Dakota consumers or the potential for fraud occurring with regard to North Dakota consumers. There has to date been no allegation of specific fraud or allegation of violation of specific statute or rule by DFI against CybrCollect.

If one of the interpretations of the law offered by the parties in this matter is to be authoritative in North Dakota, it is up to DFI to adopt a rule or for the North Dakota Legislative Assembly to pass a statute to deal with this situation of consumer risk and risk for financial institutions, if indeed there is risk.

While it may be true, without a regulatory authority entity to turn to for resolution of Automate Clearing House ("ACH") Network complaints, that the individual consumer would be left on his or her own to deal with a situation of potential fraud committed by an unscrupulous originator or its agent in business practices such as engaged in by CybrCollect; while it may be true that legal actions have been filed by others against other debt collectors who are alleged to have violated the NACHA Operating Rules; while it may be true that there is potential for misuse of consumer financial information in business practices such as engaged in by

¹ The ALJ is not concluding that a written policy would necessarily govern in this matter.

CybrCollect; while it may be true that CybrCollect causes a violation of agreements each time an RCK Entry is transmitted through the ACH Network, and the RCK entry, in turn creates the potential for liabilities in the form of fines assessed for rules violations; and while it may be true that CybrCollect's business practice exposes state-chartered financial institutions to liability in the form of monetary fines, there is no evidence that the North Dakota Legislative Assembly has filled a *parens patriae* role in this situation by authorizing DFI to regulate the debt collection agency practice of CybrCollect that is the subject of this matter. There is simply no specific state statute or rule that covers this situation, at least in regard to regulation by DFI. Action can only be taken by DFI against CybrCollect pursuant to statute or rule. *See Mullins v. ND Dept. of Human Services* 454 N.W. 2d 732 (N.D. 1990).

In other words, DFI only has authority to regulate CybrCollect as a collection agency under the Collection Agency laws. DFI has not alleged and does not have general banking regulatory authority over CybrCollect. Perhaps, others may have a remedy against CybrCollect, but DFI has no remedy under the law against CybrCollect because CybrCollect has not violated any specific state law under which its activities are regulated. DFI has been given no authority to impose NACHA rules on the operations of CybrCollect.

RECOMMENDED ORDER

DFI's Motion to Strike Pre-Hearing Brief is denied, though the ALJ relied on the parties post-hearing briefs in issuing his recommended decision.

DFI's Motion in Limine and to Limit the Scope of the Issues on Hearing is to a large extent moot and it is denied. The ALJ ruled on evidence offered at the hearing. The issues are as stated in the Notice of Hearing. However, CybrCollect's due process claim is denied. *See* Analysis of Law.

The greater weight of the evidence shows that CybrCollect has not violated the provisions of N.D.C.C. ch. 13-05, or any rules adopted under ch. 13-05, such that a cease and desist order or any other regulatory relief may be maintained by DFI against CybrCollect. The ALJ recommends that the Order be dismissed and that no further action be taken in regard to CybrCollect with regard to the issues resulting from the allegations of the Order issued in this matter.

Dated at Bismarck, North Dakota, this 24th day of June, 2003.

State of North Dakota
Timothy J. Karsky
Commissioner of Financial Institutions

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